

§ 1.884-3T Coordination of branch profits tax with second-tier withholding (temporary). [Reserved]**§ 1.884-4 Branch-level interest tax.**

(a) *General rule*—(1) *Tax on branch interest.* In the case of a foreign corporation that, during the taxable year, is engaged in trade or business in the United States or has gross income that is ECI (as defined in § 1.884-1(d)(1)(iii)), any interest paid by such trade or business (hereinafter “branch interest,” as defined in paragraph (b) of this section) shall, for purposes of subtitle A (Income Taxes), be treated as if it were paid by a domestic corporation (other than a corporation described in section 861(c)(1), relating to a domestic corporation that meets the 80 percent foreign business requirement). Thus, for example, whether such interest is treated as income from sources within the United States by the person who receives the interest shall be determined in the same manner as if such interest were paid by a domestic corporation (other than a corporation described in section 861(c)(1)). Such interest shall be subject to tax under section 871(a) or 881, and to withholding under section 1441 or 1442, in the same manner as interest paid by a domestic corporation (other than a corporation described in section 861(c)(1)) if received by a foreign person and not effectively connected with the conduct by the foreign person of a trade or business in the United States, unless the interest, if paid by a domestic corporation, would be exempt under section 871(h) or 881(c) (relating to exemption for certain portfolio interest received by a foreign person), section 871(i) or 881(d) (relating, in part, to exemption for certain bank deposit interest received by a foreign person), or another provision of the Code. Such interest shall also be treated as interest paid by a domestic corporation (other than a corporation described in section 861(c)(1)) for purposes of sections 864(c), 871(b) and 882(a) (relating to income that is effectively connected with the conduct of a trade or business within the United States) and section 904 (relating to the limitation on the foreign tax credit). For purposes of this section, a foreign corporation also shall be

treated as engaged in trade or business in the United States if, at any time during the taxable year, it owns an asset taken into account under § 1.882-5(a)(1)(ii) or (b)(1) for purposes of determining the amount of the foreign corporation’s interest expense allocated or apportioned to ECI. See paragraph (b)(8) of this section for the effect of income tax treaties on branch interest.

(2) *Tax on excess interest*—(i) Definition of excess interest. For purposes of this section, the term “excess interest” means—

(A) The amount of interest allocated or apportioned to ECI of the foreign corporation under § 1.882-5 for the taxable year, after application of § 1.884-1(e)(3); minus

(B) The foreign corporation’s branch interest (as defined in paragraph (b) of this section) for the taxable year, but not including interest accruing in a taxable year beginning before January 1, 1987; minus

(C) The amount of interest determined under paragraph (c)(2) of this section (relating to interest paid by a partnership).

(ii) *Imposition of tax.* A foreign corporation shall be liable for tax on excess interest under section 881(a) in the same manner as if such excess interest were interest paid to the foreign corporation by a wholly-owned domestic corporation (other than a corporation described in section 861(c)(1)) on the last day of the foreign corporation’s taxable year. Excess interest shall be exempt from tax under section 881(a) only as provided in paragraph (a)(2)(iii) of this section (relating to treatment of certain excess interest of banks as interest on deposits) or paragraph (c)(3) of this section (relating to income tax treaties).

(iii) *Treatment of a portion of the excess interest of banks as interest on deposits.* A portion of the excess interest of a foreign corporation that is a bank (as defined in section 585(a)(2)(B) without regard to the second sentence thereof) provided that a substantial part of its business in the United States, as well as all other countries in which it operates, consists of receiving deposits and making loans and discounts, shall be treated as interest on deposits (as described in section 871(i)(3)), and shall be